

BEFORE THE HEARING OFFICER
OF THE TAXATION AND REVENUE DEPARTMENT
OF THE STATE OF NEW MEXICO

IN THE MATTER OF THE PROTEST OF
ENTERTAINMENT PUBLICATIONS, INC.,
ID. NO. 02-099853-00 8, PROTEST
TO ASSESSMENT NO. 1821350.

No. 96-12

DECISION AND ORDER

This matter comes on for determination before Gerald B. Richardson, Hearing Officer. Entertainment Publications, Inc. (hereinafter "Taxpayer") was represented by David A. Fruchtman, Esq. The Taxation and Revenue Department (hereinafter "Department") was represented by Frank D. Katz, Chief Counsel. In lieu of a formal hearing, the matter was submitted for decision upon a stipulation of facts and briefs of the parties.

Based upon the evidence and arguments submitted IT IS DECIDED AND ORDERED as follows:

FINDINGS OF FACT

1. The Taxpayer is a Michigan corporation with its principal place of business in Troy, Michigan.
2. The Taxpayer sells a membership service which provides to its members a book of discounts and coupons for use at restaurants, for recreational activities, at movie theaters, hotels, with rental car companies and with certain other identified business establishments (collectively, the "establishments").
3. The discount membership book contains information provided by the participating establishments.
4. The Taxpayer does not provide to its members a critique or any discussion of the merits and demerits of the food, services or activities described in the discount membership book.
5. The Taxpayer does not sell or provide any of the food, services or activities

described in the discount membership book.

6. The Taxpayer does not receive any commission or other compensation from participating establishments.

7. The Taxpayer does not pay any of the establishments for including their menus or coupons in the discount membership book.

8. The Taxpayer enters into a contract, entitled "participation agreement" with the various establishments who provide discount offers for listing in the Taxpayer's membership book in return for the promotional benefits of the exposure to potential customers through the Taxpayer's membership program. Under the terms of the participation agreement, the establishments agree to provide the discounts described in the agreement to the Taxpayer's members during the term of the agreement. Additionally, the establishments agree that the Taxpayer may seek injunctive relief, including specific performance, if they breach their promise to honor the discounts and agree to pay the Taxpayer's reasonable attorney's fees in the event of a breach of the agreement by the establishments.

9. Memberships are valid for a period not exceeding 14 months and are non-transferrable.

10. When a membership expires the discounts and coupons associated with the membership expire and are no longer of any effect.

11. The Taxpayer makes new discount memberships available annually.

12. The Taxpayer does not sell expired memberships nor does it sell discount coupon books for expired years.

13. The Taxpayer does not sell the discount coupon book separately from the membership.

14. The Taxpayer has between 500 and 900 employees located outside of New Mexico.

15. The Taxpayer has between four and eight employees located within New Mexico.
16. The Taxpayer's employees located outside of New Mexico continually evaluate the type and number of establishments participating in the discount membership program to maintain a variety and quantity of participating establishments.
17. Taxpayer employees located outside of New Mexico work with printers located outside of New Mexico to organize and prepare the discount membership book. The Taxpayer employees located outside of New Mexico review proofs of the book, make changes as necessary, and engage in general quality control of the discount membership book.
18. Taxpayer employees located outside of New Mexico receive payments directly from some of the organizations selling its discount membership service.
19. Taxpayer employees located within New Mexico contact non-participating merchants to describe the discount membership service and explain the benefits of participation in the service.
20. Taxpayer employees located outside of New Mexico approve or reject all requests by establishments to participate in the Taxpayer's discount membership service.
21. Taxpayer employees located within New Mexico contact charitable organizations to describe the Taxpayer's discount membership service and explain the benefits of selling the membership service.
22. Taxpayer employees located within New Mexico distribute the discount membership cards and books to New Mexico members.
23. Taxpayer employees located within New Mexico receive payments from some of the organizations selling the Taxpayer's discount membership service, which payments are in turn transferred to Taxpayer employees located outside of New Mexico.
24. Members request movie tickets by contacting Taxpayer employees located outside of New Mexico. The contacted Taxpayer employees respond to members' requests by mailing

the requested movie tickets from outside of New Mexico. The movie tickets may be used at movie theaters located throughout the United States.

25. The Taxpayer maintains an "800" toll free telephone number for members' convenience. The Taxpayer employees answering the toll free number are located outside of New Mexico. The Taxpayer's membership book also advertises two local (Albuquerque) telephone numbers where members may call with comments or questions and may receive updates of new merchant discounts. Additionally, the membership book lists a local fax number and the address of the Taxpayer's Albuquerque office.

26. The Taxpayer publishes a newsletter advising its members of new discounts available as part of the membership. The newsletter is written by Taxpayer employees located outside of New Mexico, is printed outside of New Mexico and is mailed from outside of New Mexico.

27. Members of the Taxpayer's New Mexico membership program use their memberships for discounts on purchases mostly but not exclusively, from establishments located in New Mexico.

28. New Mexico members are not eligible for discounts and coupons not listed in the New Mexico discount membership book but listed in discount membership books sent to members in other locations.

29. On July 5, 1994, the Department issued Assessment No. 1821350 to the Taxpayer assessing \$107,968.69 in gross receipts tax, \$10,796.89 in penalty and \$30,848.86 in interest for the tax periods July 1, 1988 through December 31, 1993.

30. On August 2, 1994, the Taxpayer filed a written protest to Assessment No. 1821350.

31. The Department's audit had concluded that the Taxpayer was providing an advertising service for New Mexico merchants as the basis for concluding that the Taxpayer's

receipts from the sale of memberships was subject to gross receipts tax. The Department later agreed that the Taxpayer was not providing an advertising service.

DISCUSSION

In this case, the Taxpayer has receipts from selling memberships to members in New Mexico. Members receive a book listing discounts and containing coupons for use at various restaurants, movie theaters, hotels, rental car companies, airlines and other establishments in the entertainment industry (hereinafter "establishments"). The establishments are mostly located in New Mexico, but some, such as national airlines, car rental companies and hotels are located throughout the country and discounts are available at their locations around the country. Memberships are non-transferrable and the benefit of membership is the entitlement to the various discounts advertised in the membership book and any supplemental listings which are added during the approximately one year duration of the membership. The Taxpayer does not pay any of the establishments for the discounts provided. Rather, the establishments provide discounts in order to receive the promotional benefits of being listed in the membership book and the exposure to potential customers. The Taxpayer does not sell or provide any of the food, services or activities described in the membership book.

The parties have characterized the Taxpayer's activities as the sale of a "membership service" and the issue posed by this protest is whether the Taxpayer's receipts from the sale of these membership services is subject to New Mexico gross receipts tax. The Taxpayer argues that it performs the vast majority of the services related to its membership program from outside of New Mexico and that since the gross receipts tax is imposed upon the performance of services in New Mexico, it is therefore not subject to tax. Additionally, it argues that Section 7-1-13.1(A), which exempts the receipts from services performed out of state where the product of the service is initially used in New Mexico would operate to prohibit the tax at issue. Finally, it argues that New Mexico law requires that services be taxed where they are performed, rather than where the

product or benefit of those services is received. It asserts that it confuses its receipts from membership services with the receipts from performing services of the participating business establishments which grant the discounts, where the discounts are granted by the participating business establishments and not by the Taxpayer.

In response, the Department states that the Taxpayer is confusing its preparations to provide a service with the provision of the service itself. The Department argues that the service being provided is not the details of arranging for the discounts from establishments or listing them in an attractive book, but the provision of those discounts to its members, and that this service is performed at the place where the members utilize the discounts. The Department contends that since the Taxpayer has stipulated that its members utilize their discounts mostly with establishments located in New Mexico, that this establishes that in general, the membership services are performed in state and that the Taxpayer bears the burden of establishing the portion of its services being performed out of state.

To properly analyze the tax consequences of the Taxpayer's sale of membership services, it is necessary to analyze the various business relationships created by the Taxpayer's activities with respect to the memberships sold in New Mexico. Essentially, the Taxpayer has two categories of business relationships. First, it has its contractual relationship with the participating business establishments who grant the various discounts. The Taxpayer does not pay these establishments to receive the benefit of being able to advertise these discounts and the establishments do not pay the Taxpayer for the benefit of being advertised in the Taxpayer's membership book. Rather, the *quid pro quo* of this relationship is that the establishments receive the promotional benefits of exposure to potential customers who buy memberships and receive the membership discount book in return for their agreement to provide various discounts to the Taxpayer's members. The Taxpayer's members who receive the benefit of this relationship, the discounts offered, are not parties to this contractual relationship and have no role in determining

the terms or conditions of the discounts offered.

The other category of business relationship created by the Taxpayer's activities is the membership relationship between the Taxpayer and the members in New Mexico who purchase memberships. The membership entitles a member to the membership discount book containing coupons and information about how to obtain the various discounts offered by the establishments advertised in the membership book as well as periodic newsletters containing information about additional business establishments now offering discounts.

The crux of the matter to be determined is what services are being performed by the Taxpayer and where are those services being performed. The Department has assessed gross receipts tax based upon the Taxpayer's receipts from selling memberships in New Mexico, not upon any value attributed to the promotional benefits received by the establishments offering the discounts. Thus, it is the business relationship between the Taxpayer and the members which must be examined to determine this matter.

What is the reasonable expectation of a person who is approached to purchase such a membership? What does that person obtain in return for the price paid for a membership? Clearly, that person expects to obtain the benefit of the right to avail himself of the discounts offered through the Taxpayer's membership program. This is the service purchased, regardless of the fact that the Taxpayer has a separate contractual relationship with the establishments who actually provide the discount offered which allows the Taxpayer to advertise and offer the discounts to its members. The member wasn't privy to that contractual relationship and did not determine the terms of that relationship, but once those terms were agreed to by the Taxpayer and the establishments and offered as part of the Taxpayer's membership program, the member can reasonably expect that those terms will be honored.¹ Thus, it is not relevant that the actual

¹ The Taxpayer's Reply Brief cites to the extremely fine print on page two of the membership book whereby the Taxpayer eschews responsibility if any establishment fails to comply with the terms of any offered discounts as evidence that it is not liable for any failure of the discounts offered as part of its membership program. The enforceability of such a disclaimer is highly questionable, but is not an issue herein. If it were printed in such a manner that a member would reasonably be aware of it in

discounts, if availed of, are granted by the establishments. The discounts remain the essential element of the membership service offered by the Taxpayer which is purchased by the member.

Having determined the nature of the membership service, it remains to be determined where that membership service is performed because the gross receipts tax is not imposed on services which are performed outside of New Mexico. *See*, Section 7-9-13.1(A), which exempts from gross receipts tax the receipts from performing services outside of New Mexico, the product of which is initially used in New Mexico. The Taxpayer argues that since the majority² of its efforts with respect to its membership program, such as accepting establishments into the program and the creation of the membership book occur out of state, that it should be considered to be performing services out of state. This argument confuses the services being performed with the Taxpayer's preparations to offer the services to its members. It is of no consequence to the member where the membership book is assembled and printed or where or how the negotiations between the Taxpayer and the establishments were conducted. Where those activities occurred has no bearing on what the member is looking to gain from the membership relationship, the availability of the discounts. The location of those activities is of no more consequence to members than it is to me to know where my plumber bought his tools and supplies when I hire him to fix my toilet. What is relevant is where those discounts are available. The New Mexico membership book, sold only to New Mexico members, offers discounts, which are mostly

determining whether to purchase a membership, its effect would be relevant to the determination of the reasonable expectation of the members as to what service was being purchased when a membership is purchased.

² The factual record herein is not very well developed with respect to evaluating the portion of the activities with respect to the Taxpayer's membership program which are performed in state versus out of state. The actual contact and recruitment of establishments in New Mexico for potential listing in the membership discount book is performed by New Mexico employees, although the approval of an establishment for listing in the book, and the copy to be printed are finalized out of state. While the Taxpayer has an out of state "800" number for membership inquiries, the membership book only advertises the local (Albuquerque) numbers prominently and solicits comments and questions at those numbers. Although the clear majority of Taxpayer employees are located out of state, it is not at all clear how many of those out of state employees work out of the Taxpayer headquarters and how many are located in the various other venues where the Taxpayer's membership program operates. Thus, at this point, it is merely the Taxpayer's allegation that the majority of its membership services are performed out of state, but because the factual record is insufficient to form a conclusion on this issue there has been no finding of fact on that matter.

available in New Mexico. Thus, it is the locations where members may avail themselves of the discounts offered which determines the locus of the service performed.

The Taxpayer relies upon *Advance Schools, Inc. v. Bureau of Revenue*, 89 N.M. 79, 547 P.2d 562 (1976), the only New Mexico case where the imposition of gross receipts tax turned upon the determination of where the service was performed. In that case, the supreme court determined that the receipts of a correspondence school, were exempt from gross receipts tax as the services were performed out of state. That case is distinguishable from the instant case, however, because there, the services directly provided to students, the correction and grading of work and exams, and the consulting with and counseling of students were performed out of state. The service in this case, the providing of discounts through third party contractors, takes place where those discounts are provided.

Having determined that a large portion of the Taxpayer's membership services are performed in New Mexico where the discounts are provided, it remains to be determined which portion of the gross receipts assessed can be attributed to services performed in New Mexico. The Taxpayer has failed to present any proof on this issue, instead, relying upon its allegation that the Department would bear the burden of proof on this issue. The basis for the Taxpayer's position that the Department bears the burden of proof on this issue is that the Department has since conceded that the legal basis provided by the Department's auditor at the time of the assessment is not correct.³ The Taxpayer argues that therefore, the presumption of correctness which would normally attach to an assessment of taxes by the Department pursuant to Section 7-1-17 NMSA 1978 no longer applies and that the burden of proof is now shifted to the Department.

The Taxpayer's argument is misplaced. The presumption of correctness attaches to the

³ The Department's auditor had assessed the Taxpayer on the basis that its membership sales receipts were the receipts from providing an advertising service for New Mexico merchants. By letter dated November 2, 1994, the Department admitted that the Taxpayer was not providing advertising services

factual basis of an assessment, not the *legal* basis stated in the audit narrative. As noted by the court of appeals in *Champion International Corp. v. Bureau of Revenue*, 88 N.M. 411, 413, 540 P.2d 1300 (Ct. App. 1975), "Any assessment of taxes made by the bureau is presumed correct The duty rests on Champion to present 'evidence tending to dispute the *factual* correctness of the assessment.' *McConnell v. State ex rel. Bureau of Revenue*, 83 N.M. 836." (emphasis added). In this case, the factual basis of the assessment was the treatment of the Taxpayer's receipts from the sale of memberships in New Mexico as shown on its bank deposits as the Taxpayer's gross receipts. See, p. 2 of general audit narrative. The Taxpayer has not disputed the correctness of the amounts picked up by the Department's auditor as reflecting sales of New Mexico memberships. Rather, the Taxpayer has focused its defense upon only the legal basis for concluding that those receipts are subject to tax. Additionally, there exists yet another statutory presumption which the Taxpayer has not addressed. In addition to the presumption of correctness which attaches to any assessment by the Department, Section 7-9-5 NMSA 1978 provides that:

To prevent evasion of the gross receipts tax and to aid in its administration, it is presumed that all receipts of a person engaging in business are subject to the gross receipts tax. Any person engaged solely in transactions specifically exempt under the provisions of the Gross Receipts and Compensating Tax Act shall not be required to register or file a return under this act.

Thus, even if the presumption of correctness of Section 7-1-17 did not apply, the Taxpayer would still bear the burden of proving that its receipts from the sale of memberships in New Mexico were not gross receipts from engaging in business in New Mexico. It also makes sense for the Taxpayer to bear this burden of proof. It is the Taxpayer who is in the best position to know the nature and extent of its business activities within and without New Mexico. The Taxpayer has all of the information available upon which to base any determination of the proper apportionment of its receipts between in state and out of state services performed for its members. Having failed to present any evidence as to what portion of its receipts could reasonably be attributed to the

provision of discounts outside of New Mexico, the presumption that all of its receipts from the sale of memberships to New Mexico members are receipts from providing services in New Mexico stands.

CONCLUSIONS OF LAW

1. The Taxpayer filed a timely, written protest to Assessment No. 1821350 and jurisdiction lies over the parties and the subject matter of this protest.
2. The presumption of correctness which attaches to assessments of tax by the Department pursuant to Section 7-1-17 NMSA 1978 applies to the factual basis of the assessment and not the legal basis contained in the Department's audit narrative.
3. The burden of proof was on the Taxpayer to prove that its receipts from the sale of membership services to New Mexico members was not subject to gross receipts tax.
4. The membership services provided by the Taxpayer is the provision of discounts, through its third party contractors, to the Taxpayer's members.
5. The Taxpayer's membership services are rendered at the place where the members avail themselves of the discounts offered as part of the Taxpayer's membership program.
6. The Taxpayer failed to carry its burden of proof herein.

For the foregoing reasons, the Taxpayer's protest IS HEREBY DENIED.

DONE, this 18th day of April, 1996.